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CABINET AFFAIRS STAFFING MEMORANDUM

Date: 4/13/84   Number: 168969CA   Due By: _____

Subject: Cabinet Council on Economic Affairs - April 17, 1984

8:45 a.m. - Roosevelt Room

TOPICS: Financial Condition of Utilities
Economic Impact of Internat'l Trade

	Action	FYI		Action	FYI
ALL CABINET MEMBERS	☐	☐	CEA	☑	☐
Vice President	☑	☐	CEQ	☐	☐
State	☑	☐	OSTP	☐	☐
Treasury	☑	☐	_____	☐	☐
Defense	☑	☐	_____	☐	☐
Attorney General	☐	☑	_____	☐	
Interior	☐	☑			
Agriculture	☑	☐			
Commerce	☑	☐	Baker	☑	☐
Labor	☑	☐	Deaver	☐	☑
HHS	☐	☑	Darman (For WH Staffing)	☑	☐
HUD	☑	☐	Jenkins	☐	☑
Transportation	☑	☐	Mc Farlane	☐	☑
Energy	☐	☑	Svahn	☑	☐
Education	☐	☑	_____	☐	☐
Counsellor	☑	☐	_____	☐	☐
OMB	☑	☐	_____	☐	☐
CIA	☐	☑	_____	☐	☐
UN	☐	☑	_____	☐	☐
USTR	☑	☐			
			CCCT/Gunn	☐	☐
GSA	☐	☐	CCEA/Porter	☑	☐
EPA	☐	☐	CCFA/	☐	☐
OPM	☐	☐	CCHR/Simmons	☐	☐
VA	☐	☐	CCLP/Uhlmann	☐	☐
SBA	☐	☐	CCMA/Bledsoe	☐	☐
			CCNRE/	☐	☐

REMARKS:

There will be a meeting of the Cabinet Council on Economic
Affairs on Tuesday, April 17, 1984, at 8:45 a.m. in the
Roosevelt Room.

The agenda and background paper for the second agenda
item are attached.

DCI
EXEC
REG

RETURN TO:

☐ Craig L. Fuller
Assistant to the President
for Cabinet Affairs
456-2823

☐ Katherine Anderson
☑ Tom Gibson
Associate Director
Office of Cabinet Affairs

☐ Don Clarey
☐ Larry Herbolsheimer

L-300B

THE WHITE HOUSE

WASHINGTON

April 13, 1984

MEMORANDUM FOR THE CABINET COUNCIL ON ECONOMIC AFFAIRS

FROM: ROGER B. PORTER *RBP*

SUBJECT: Agenda and Paper for the April 17 Meeting

The agenda and paper for the April 17 meeting of the
Cabinet Council on Economic Affairs are attached. The meet-
ing is scheduled for 8:45 a.m. in the Roosevelt Room.

The Council will consider two agenda items. The first
is a report from the Working Group on the Financial Condi-
tion of Utilities. This recently formed working group has
been surveying the financial viability of a number of major
utilities involved in the construction of nuclear power
plants. No papers will be distributed for this agenda item
in advance of the meeting.

The second agenda item is a report from the Working
Group on the Economic Impact of International Trade. At
its January 26, 1984 meeting the Council asked the Working
Group to analyze the implications of a decline in the value
of the U.S. dollar for key economic variables. The Working
Group prepared the attached memorandum which analyzes the
economic impact of a decline in the dollar under four differ-
ent scenarios.

Attachments

THE WHITE HOUSE

WASHINGTON

CABINET COUNCIL ON ECONOMIC AFFAIRS

April 17, 1984

8:45 a.m.

Roosevelt Room

AGENDA

1. Report of the Working Group on the Financial Condition
    of Utilities   (CM # 468)

2. Report of the Working Group on the Economic Impact of
    International Trade   (CM # 409)

UNITED STATES DEPARTMENT OF COMMERCE
The Under Secretary for Economic Affairs
Washington, D.C. 20230

FOR OFFICIAL USE ONLY   MAR 29 1984

MEMORANDUM FOR: Cabinet Council on Economic Affairs

FROM: Sidney L. Jones
                Under Secretary
                for Economic Affairs

SUBJECT: Effects of Depreciation of the Dollar on the
                U.S. Economy

At a CCEA meeting on January 26, 1984, the Working Group on the
Economic Impact of International Trade was asked to analyze the
implications of a decline in the value of the U.S. dollar on
key economic variables. The Working Group has prepared the
following analysis.

In the future, the exchange value of the U.S. dollar must
fall. If the current strength of the dollar were to persist,
the large current account deficit would also persist and grow.
This is not possible, because the world's financial investors
would not be willing to go on absorbing the ever-growing volume
of U.S. public and private securities that would be implied by
these expanding current account deficits. Thus the dollar must
decline until the trade deficit shrinks and the current account
reaches a sustainable level much closer to balance.

No one can be sure how long it will take or how rapidly the
dollar will fall. It could take the rest of the decade and
beyond, with the dollar declining at a rate of 3 or 4 percent a
year. Or it could happen much more quickly with a drop of 20
percent or more in a single year. Or it could decline at a
rate between these extremes. It is also possible that the
dollar will increase in value in 1984, as in 1983.

There is now substantial interest in the possible consequences
of a sharp decline in the dollar. To financial institutions,
the dollar is an investment asset just like domestic stocks and
bonds. A sudden change in expectations or sentiments could
cause a sharp change in the value of the dollar even with no
obvious cause or concurrent change in economic conditions.
Alternatively, of course, a decline in the dollar could occur
in response to a change in macroeconomic policy that leads to a
reduction in the rate of return on U.S. assets.

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Unclassified Upon Removal of
Classified Attachment(s)

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The Effect of a Dollar Decline

The obvious direct effect of a decline in the value of the dollar would be an increase in exports and a decline in imports. This improvement in the trade balance would induce a corresponding improvement in the current account balance.

Experience shows that these changes occur with a lag because of delays in adjusting purchases to the changed competitiveness of the dollar. In the very short run, a decline of the dollar would actually increase the current account deficit because the quantities of exports and imports would initially change very little while the dollar price of exports would decline and the dollar price of imports would rise.

Eventually, however, a decline in the value of the dollar would cause the current account balance to improve. Just as the rise in the value of the dollar and the consequent deterioration in the current account balance had some beneficial side effects, a decline in the value of the dollar, with the improvement in the current account balance, would have a detrimental side effect in capital markets.

The beneficial side effect in the capital markets of the large current account deficit can be seen in the following way. Our purchases of imported goods provide dollars to foreigners. Foreigners can use those dollars either to buy our export commodities or to buy capital in the United States. Our current account deficit indicates that foreigners have not used the dollars we paid for imports to buy our export commodities; instead, they must be using the dollars to purchase capital. (Of course, foreigners could simply hold the dollars. This, too, is a form of investing in the United States; it is just that the investment is an interest-free loan to us of the amount of dollars that foreigners wish to hold.)

As the dollar declines in value, foreigners will find that (a) eventually we choose to import less and thus we provide them with fewer dollars and (b) they will choose to purchase more of our export commodities because of the lower price. Consequently, there will be fewer foreigners resulting in a rise in interest rates. Although industries that export will in general expand, the higher interest rates will cause a relative contraction of the capital goods industry and other interest-sensitive sectors.

The contraction in the investment goods industry may not show up in absolute declines in investment goods if the overall effect of the dollar depreciation is to cause output to grow. The BEA model suggests that overall real GNP will grow

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with the dollar depreciation and that the net effect will be to raise investment. Other models suggest that investment will fall.

Regardless of why the dollar falls, its immediate impact would be an increase in prices in the United States. Just as the climb in the dollar reduced inflation over the past three years, the future fall in the dollar will temporarily raise the rate of inflation. More accurately, with an unchanged path of money growth, a rapid decline in the dollar exchange rate this year would tend to raise the rate of inflation above the 5 percent rate that the Administration projected.

The depreciation of the dollar would, however, also lead to higher real growth of GNP and lower unemployment but higher interest rates.

Econometric Analysis

Four forecasts through 1987 were made with the BEA Quarterly Econometric Model to examine the effects of alternative assumptions concerning the depreciation of the dollar on the U.S. economy. The first--the baseline forecast-- assumes no change in the value of the dollar through 1987. The second assumes a 20-percent depreciation by the end of 1984. The third assumes a 40-percent depreciation by the end of 1984. The fourth assumes a 30-percent depreciation by the end of 1985. The depreciations are assumed to be caused by factors external to the U.S. economy rather than by domestic policy changes.

The attached tables present the four forecasts and compare the second, third, and fourth with the baseline forecast.

Twenty-percent depreciation over one year.--Current-dollar net exports of goods and services are lower in 1984 than in the baseline forecast, as lower volumes of imports are more than offset by higher prices, and as exports react slowly to the dollar's depreciation. Thereafter, net exports are increasingly higher, as import volumes continue to decline and export volumes continue to increase. By 1987, net exports are $51 billion higher. (The forecasts of net exports are shown in chart 1. Those based on the assumption of dollar depreciation show what is often called the J-curve pattern.) Inflation is also higher in each year, as higher import prices feed through to higher domestic prices. Real (constant-dollar) GNP is increasingly higher in each year; the peak difference is registered in 1987-I. Higher real net exports account for nearly all of the difference in real GNP; changes in other real GNP components largely offset one another. Personal consumption expenditures

are lower throughout, reflecting increased consumer uncertainty
and lower real consumer wealth, both arising from higher
inflation. Nonresidential fixed investment is increasingly
higher as real interest rates are slightly lower in 1984 and
early 1985 and as expanding export markets cause capacity
utilization to rise. In subsequent periods the interest rate
effect will strengthen holding down nonresidential fixed
investment. Residential investment declines more rapidly,
reflecting higher interest rates. Real government purchases
are also lower, reflecting higher prices and the assumption
that Federal government current-dollar purchases do not vary
with price changes traceable to dollar depreciation.

The unemployment rate decreases more rapidly, reflecting higher
real GNP growth, which more than offsets slightly higher labor
productivity. After 1984, the lagged effects of higher
inflation and lower unemployment combine to yield increasingly
higher wage rate growth (which in turn contributes to higher
inflation). The higher demand for money resulting from the
increasingly higher current-dollar GNP after 1984 leads to
higher short- and long-term interest rates. The Federal
deficit decreases more rapidly ($18 billion lower in 1987), as
the increase in receipts generated by higher inflation more
than offsets the increase in interest payments resulting from
higher interest rates.

Forty-percent depreciation over one year.--The effects on the
economy of a 40-percent depreciation are generally more than
double the effects of a 20-percent depreciation. For example,
the effect on current-dollar net exports in 1987 is $127
billion (table 3), compared with $51 billion (table 2). The
effect on real GNP is nearly three times as large; in 1987,
real GNP is up $63 billion, compared with $24 billion. (The
larger-than-proportional differences in real GNP are due to the
disproportionate responses of real exports, the effects of the
accelerator on investment, and the nonlinearities of price
behavior.) The 40-percent depreciation also results in
more-than-proportionate increases in inflation and interest
rates. The Federal deficit benefits substantially from the
larger depreciation of the dollar; in 1987, it is $47 billion
lower than in the baseline forecast.

Thirty-percent depreciation over two years.--The effects on the
economy of a 30-percent depreciation show a somewhat different
pattern than the two other forecasts with depreciations. The
difference is due to the more gradual nature of the 30-percent
depreciation; by the end of 1984, the value of the dollar
depreciates only 15 percent, compared with 20 percent and 40
percent in the two other forecasts. While in the two other
forecasts there is no further depreciation after 1984-IV,
depreciation continues through 1984-IV in this forecast.

Consequently, in the first half of the forecast period the
effects on net exports and other aspects of the economy are
smaller than for 20-percent depreciation, but they are larger
in the second half of the forecast period. By 1987, the
effects of the 30-percent depreciation are closer to those of
the 20-percent depreciation than those of the 40-percent
depreciation because the effects of the 30-percent depreciation
have not had enough time to work their way fully through the
economy. For example, the effect on net exports in 1987 is
$72.1 billion, compared with $51.4 billion and $127.1 billion
for the 20-percent and 40-percent depreciations, respectively.

The effects on other aspects of the economy are also smaller in
1984 than for a 20-percent depreciation. After that, they are
slightly larger, and by 1987 are roughly 1.5 times the effects
of the 20-percent depreciation.

Comparison with other estimates.--The impacts of depreciation
on current-dollar net exports presented here are in line with
recent estimates made by the Council of Economic Advisers (see
Economic Report of the President, February 1984, page 47) and
those made by the staff of the Federal Reserve Board using the
U.S. accounts sector of its multi-country model. The impacts
are somewhat larger, however, than those shown by a Federal
Reserve study using its full multi-country model, which allows
for feedbacks on the U.S. economy from foreign economies and
for feedbacks from the U.S. economy on foreign economies.

Major Assumptions

These forecasts were prepared by extending the January 24 BEA
forecast through 1987-IV and incorporating two major changes in
assumptions. The first change incorporates the tax and
expenditures policies contained in the Budget of the United
States Government, Fiscal Year 1985. As noted earlier,
current-dollar Federal Government purchases are the same in all
three forecasts.

The second change involves different assumptions about the
trade-weighted value of the dollar used in the model. (In the
January 24 forecast, the dollar was assumed to depreciate 20
percent by 1986-I.) The baseline forecast assumes that the
trade-weighted value of the dollar remains constant at its
year-end 1983 level through 1987. The second forecast differs
from the baseline forecast in that it assumes that the
trade-weighted index of the value of the dollar declines 20
percent by the end of 1984, with .15 of the decline occurring
in 1984-I, .35 in both 1984-II and 1984-II and 1984-III, and
.15 in 1984-IV. The third forecast assumes that the value of

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the dollar declines 40 percent by the end of 1984, with the same shares of the decline occurring in each of the quarters of 1984 as in the second forecast. The fourth forecast assumes that the value of the dollar declines 30 percent by the end of 1985, with .075 of the decline occurring in 1984-1, .125 in 1984-II, .15 in 1984-III, 1984-IV, 1985-I, and 1985-II, .125 in 1985-III, and .075 in 1985-IV.

In addition, the following should be noted:

o The Federal Reserve Board maintains the same increase in the (M2) money supply in the three forecasts. (If the Federal Reserve were accommodative, interest rates would rise by less, real GNP growth would be higher, and inflation might also be higher, net exports would probably be lower.

o Foreign economic growth and inflation are the same in the three forecasts. (Because the depreciation of the dollar would probably lead to somewhat slower growth and lower inflation abroad, the beneficial effects on current-dollar net exports may be slightly optimistic.)

o The price per barrel and the volume of oil imported into the United States are the same in the three forecasts. (If the price of oil were raised by oil-exporting nations to recoup some exchange-rate losses, U.S. current-dollar imports would rise, offsetting some of the positive effects of the depreciation on current-dollar net exports.)

o One-half of the changes in the value of the dollar are passed through, with lags, to the deflator for nonoil merchandise imports. This assumption is in line with historical relationships. (If a larger proportion of changes in the value of the dollar were passed through to the deflator for nonoil merchandise imports, U.S. inflation would be higher, and the effects on real GNP and current-dollar next exports would be small and uncertain).

o Foreign prices of nonferrous metals change by one-half of the change in the value of the dollar. (If foreign prices changed more, U.S. inflation would be higher, real GNP would probably be lower, and the effect on current-dollar net exports would probably be lower.)

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o **Unit sales prices of imported autos are unchanged in the forecasts based on 20-percent and 30-percent depreciations because it is likely that higher import prices of these magnitudes will be absorbed by dealers. In the 40-percent depreciation forecast, about one-half of the higher import prices are passed through to unit sales prices.**

Altering Economic Policy

The critical question for economic policy is whether it is appropriate to alter policy if there is a sharp drop in the dollar's value. The possibilities include intervention in exchange markets, and more restrictive monetary and/or fiscal policy.

Exchange Market Intervention

One possible response to a decline of the dollar would be exchange market intervention, buying dollars and selling other currencies in an attempt to raise the dollar's value. Since buying dollars in this way would reduce the money supply, it is customary to accompany such a transaction with an equal swap of dollars for outstanding government bonds. The effect of this pair of transactions is to leave the money supply unchanged but to increase the outstanding volume of foreign currency or securities and to reduce the outstanding volume of U.S. government bonds. Because the money supply is kept unchanged, this form of exchange market intervention is known as sterilized intervention.

The experience of the United States and of other countries shows quite clearly that sterilized intervention has little or no lasting effect on exchange rates. It has therefore been the policy of the Reagan Administration to use exchange rate intervention only to calm disorderly markets. <u>The Working Group recognizes that any attempt to offset a significant shift of the dollar's value by sterilized intervention would be futile</u>.

Monetary Policy

Preventing a fall in the dollar's value could be achieved by a tightening of monetary policy. A reduction in the supply of money (in exchange for bonds or for foreign currencies) would raise the interest rate in the United States and strengthen the dollar. But tightening money in this way would have the undesirable effect of reducing the level of economic activity. Since the dollar must eventually come down to an equilibrium level, there is nothing to recommend the use of a contractionary monetary policy to postpone this inevitable exchange rate adjustment.

A more expansionary monetary policy would inevitably exacerbate the rise in the domestic price level caused by the exchange rate depreciation. Moreover, the combination of the initial exchange rate depreciation and the expansionary monetary policy could generate expectations of increased inflation, expectations that could easily depress the dollar further and thereby be self-fullfilling.

If the dollar decline were to occur, as now, at a time of less than full employment, there would be room for non-inflationary economic expansion. The rise in net exports would induce increases in consumption, output, and employment. In the BEA model investment increases, but the actual change in investment will depend on the relative strength of the interest rate effect restricting investment and the income effect stimulating investment.

These considerations imply that it is best not to alter the monetary policy in response to an unanticipated and spontaneous decline (or rise) in the dollar's value. It is therefore appropriate that the Federal Reserve's target ranges for the monetary aggregates are not made conditional on the future course of the exchange rate.

Fiscal Policy

If the dollar decline were to occur at a time of less than full employment, the economy would expand and interest rates would tend to rise. The higher interest rates would tend to discourage investment, but in the BEA model after two years investment begins to rise, nonetheless because of the higher level of economic activity.

If faster growth in investment were desired, selective cuts in the government budget would reduce interest rates and free up resources for further expansion of investment, although such cuts might also reduce demand and GNP.

A tax increase would also slow GNP growth and would retard investment if it fell on capital investment or income from capital. A tax increase that does fall on investment could exacerbate the capital outflow and dollar decline by lowering the after tax return on U.S. investment. A similar tax reduction could lower the cost of capital, raise the rate of return on U.S. investment, promote investment, and stem the dollar decline.

The best way to avoid the adverse effects of a dollar decline on the real interest rate and on investment activity is to see that the dollar decline accompanies a reduction in the anticipated future budget deficits. This provides a further reason why reducing the projected budget deficits is so important at the present time. Of course, the effects of a

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policy change reducing the deficit would depend on the specific nature of that change. The most appropriate policy response would be a reduction in government spending to make room for more net exports. Tax increases would be a second-best choice. If tax increases were needed, damage would be minimized if they were designed to fall more heavily on consumption than on U.S. capital investment or U.S. labor inputs, to avoid weakening U.S., competitiveness.

NET EXPORTS OF GOODS AND SERVICES

BILLIONS $

40-Percent Depr.

30-Percent Depr.

20-Percent Depr.
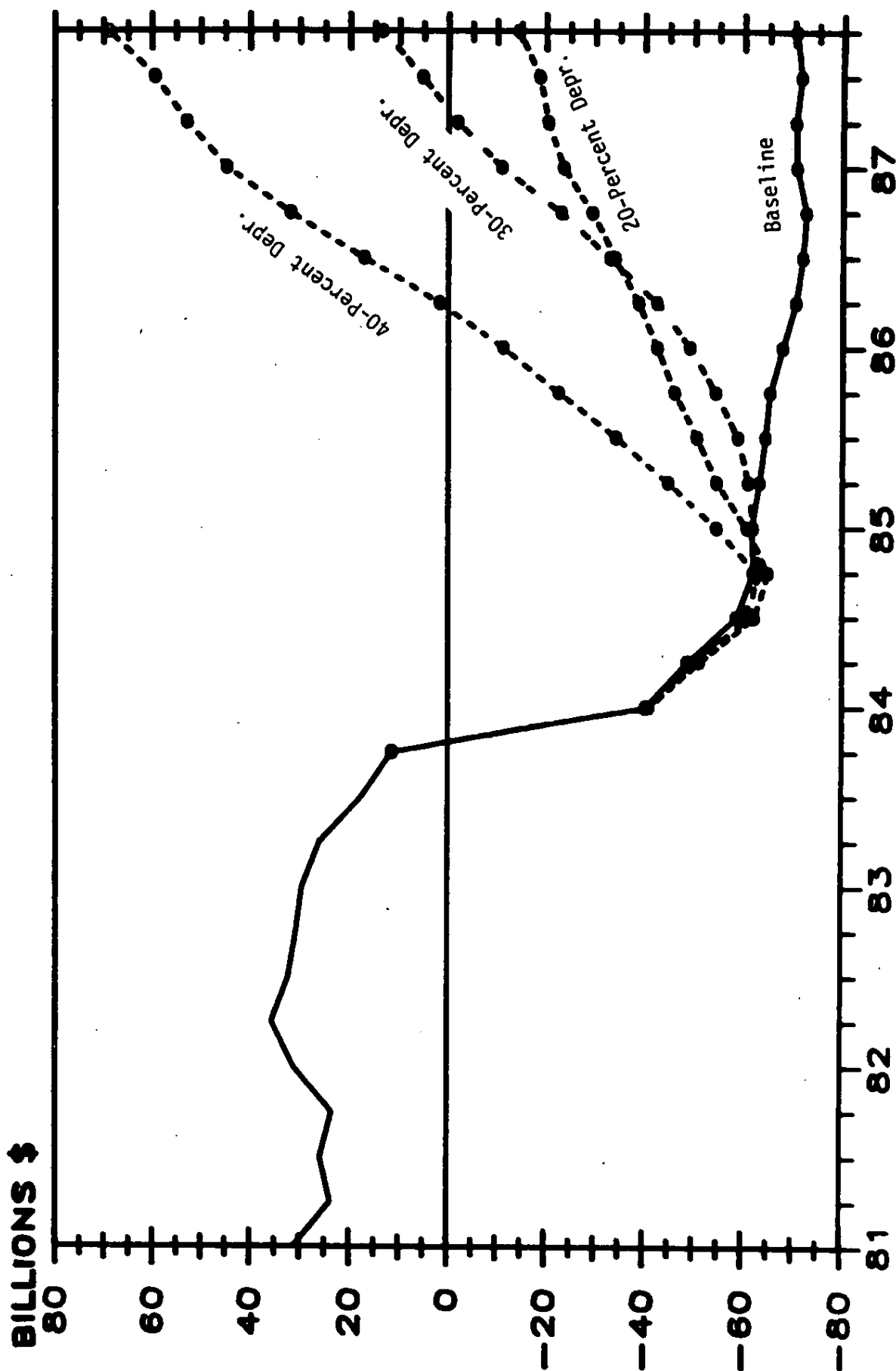
Baseline

Source: Bureau of Economic Analysis

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BEA QUARTERLY ECONOMETRIC MODEL FORECAST

FEBRUARY 17, 1984

TABLE 1.--BASELINE (NO DEPRECIATION OF DOLLAR)

	LEVELS				PERCENT CHANGES / CHANGES							
	1984	1985	1986	1987	1984	1985	1986	1987	84-IV/83-IV	85-IV/84-IV	86-IV/85-IV	87-IV/86-IV
Gross National Product (GNP) (1)	3647.6	3964.0	4311.3	4724.3	10.2	8.7	8.8	9.6	9.9	8.5	8.6	10.0
GNP Implicit Price Deflator (2)	225.2	235.7	248.8	263.8	4.5	4.7	5.5	6.1	4.7	5.0	5.9	6.1
Compensation Per Hour (3)	362.8	385.0	410.9	441.6	4.9	6.1	6.7	7.5	5.5	6.3	7.1	7.7
Output Per Hour (3)	127.3	129.5	131.2	133.4	2.4	1.7	1.3	1.6	2.4	1.3	1.1	1.9
Value of the Dollar (4)	0.98	0.98	0.98	0.98	2.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Real GNP (5)	1619.5	1681.7	1733.1	1790.7	5.5	3.0	3.1	3.3	5.0	3.3	2.6	3.7
Personal Consumption Expenditures (5)	1054.1	1087.0	1116.6	1152.4	4.2	3.1	2.7	3.2	3.2	3.2	2.4	3.6
Nonresidential Fixed Investment (5)	191.2	206.9	219.5	231.1	13.8	8.3	6.1	5.3	11.1	6.9	4.9	5.7
Residential Investment (5)	56.1	56.5	57.5	59.9	6.4	0.6	1.8	4.2	0.0	1.3	1.9	5.1
Government Purchases (5)	307.9	324.9	336.3	343.3	5.0	5.5	3.5	2.1	8.8	2.8	3.3	1.7
Inventory Investment (5)	18.3	17.8	16.2	16.3	20.7	-0.5	-1.7	0.2	13.1	-3.4	-2.2	1.6
Net Imports of Goods and Services (5)	-8.1	-11.4	-13.0	-12.4	-19.8	-3.2	-1.6	0.6	-14.2	0.1	-2.0	1.5
Civilian Unemployment Rate (6)	7.8	7.3	7.0	6.5	-1.8	-0.5	-0.4	-0.4	-0.9	-0.4	-0.2	-0.5
Federal Deficit (NIPA Basis) (1)	186.6	186.4	208.9	215.0	-3.9	-0.2	22.4	6.2	-7.7	4.9	26.9	-5.0
91-Day Treasury Bill Yield (6)	9.2	9.7	10.5	10.2	0.6	0.5	0.8	-0.3	0.2	1.0	0.8	-0.6
Moody's Corporate Bond Yield (6)	12.5	11.9	12.3	12.5	-0.3	-0.6	0.4	0.2	-0.8	-0.1	0.6	-0.6
Velocity (M2)	1.60	1.61	1.62	1.63	0.03	0.01	0.01	0.01	0.03	0.01	0.01	0.02
Net Exports of Goods and Services (1)	-52.4	-63.6	-70.6	-70.7	-41.8	-11.2	-7.0	-0.1	-29.3	-3.4	-7.2	2.2
Exports (1)	366.2	401.0	439.1	482.2	30.4	34.8	38.1	43.1	30.6	37.1	37.9	45.8
Imports (1)	418.6	464.6	509.7	552.8	72.2	46.0	45.1	43.1	59.9	40.4	45.2	43.6

1. Billions of Dollars 2. Index (1972=100) 3. Index (1967=100) 4. Index (1970=1.00) 5. Billions of 1972 Dollars 6. Percent

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DRI QUARTERLY ECONOMETRIC MODEL FORECAST
FEBRUARY 17, 1984

TABLE 2.--20-PERCENT DOLLAR DEPRECIATION

	1984	1985	1986	1987	1984	1985	1986	1987	84-1V/83-1V	85-1V/84-1V	86-1V/85-1V	87-1V/86-1V
		------- LEVELS -------									----- PERCENT CHANGES -----			
Gross National Product (GNP) (1)	3646.0	3906.8	4393.7	4842.7	10.2	9.3	10.2	10.2	9.8	9.7	9.9	10.3
GNP Implicit Price Deflator (2)	225.4	246.6	250.6	266.9	4.5	5.0	5.9	6.5	4.0	5.4	6.2	6.5
Compensation Per Hour (3)	362.9	395.6	412.8	445.4	4.9	6.3	7.0	7.9	5.5	6.6	7.4	8.2
Output Per Hour (3)	127.1	129.7	132.4	134.4	2.2	2.0	2.1	1.5	2.2	1.9	1.7	1.5
Value of the Dollar (4)	0.86	0.79	0.79	0.79	-10.0	-8.6	0.0	0.0	-20.0	0.0	0.0	0.0
Real GNP (5)												
Personal Consumption Expenditures (5)	1617.6	1685.2	1753.6	1814.0	5.4	4.2	4.1	3.5	4.8	4.1	3.5	3.5
Nonresidential Fixed Investment (5)	1051.0	1079.9	1113.8	1150.2	3.9	2.8	3.1	3.3	2.6	3.3	2.7	3.5
Residential Investment (5)	193.8	207.1	224.4	238.1	13.5	0.6	8.3	6.1	10.6	8.2	7.1	5.6
Government Purchases (5)	56.1	55.9	55.8	56.8	6.3	-0.2	-0.2	1.8	-0.2	-0.1	-0.3	2.9
	307.7	324.3	335.6	342.2	4.9	5.4	3.5	2.0	8.7	2.7	3.3	1.5
									----- CHANGES -----			
Inventory Investment (5)	10.0	18.3	19.0	18.4	20.4	0.3	0.7	-0.6	12.6	-1.5	-0.6	-0.2
Net Exports of Goods and Services (5)	-6.0	-0.4	5.0	9.1	-17.7	5.6	5.4	4.0	-9.2	8.9	4.4	3.4
									----- PERCENT CHANGES -----			
Civilian Unemployment Rate (6)	7.8	7.1	6.7	6.2	-1.7	-0.6	-0.6	-0.5	-0.9	-0.6	-0.4	-0.6
Federal Deficit (NIPA Basis) (1)	185.7	182.7	193.6	197.5	3.0	-3.0	11.0	3.8	-8.4	-2.0	16.4	-2.7
91-Day Treasury Bill Yield (6)	9.2	10.1	11.5	11.6	0.6	-0.9	1.4	3.1	0.3	1.6	1.5	-0.3
Moody's Corporate Bond Yield (6)	12.5	12.1	13.0	13.7	-0.3	-0.4	0.9	0.7	-0.8	0.2	-1.2	0.5
Velocity (K2)	1.60	1.62	1.65	1.68	0.03	0.02	0.03	0.02	0.01	0.03	0.03	0.02
Net Exports of Goods and Services (1)	-54.7	-57.9	-36.2	-19.3	-44.1	1.8	16.7	16.9	-32.4	10.9	16.5	15.0
Exports (1)	369.2	418.8	463.8	549.9	33.4	49.6	65.0	66.1	39.6	56.6	69.1	62.8
Imports (1)	423.9	471.8	520.0	569.3	77.5	47.9	48.2	49.3	72.1	37.6	52.5	47.9

DIFFERENCES FROM BASELINE FORECAST

	1984	1985	1986	1987	1984	1985	1986	1987	84-1V/83-1V	85-1V/84-1V	86-1V/85-1V	87-1V/86-1V
		------- LEVELS -------									----- PERCENT CHANGES -----			
Gross National Product (GNP) (1)	-1.6	22.6	82.5	110.5	-0.0	0.7	1.4	0.6	-0.1	1.2	1.3	0.3
GNP Implicit Price Deflator (2)	0.2	0.9	1.8	3.0	0.1	0.3	0.4	0.4	-0.1	0.4	0.4	0.5
Compensation Per Hour (3)	0.0	0.6	1.9	3.8	0.0	0.2	0.3	0.4	0.0	0.2	0.4	0.5
Output Per Hour (3)	-0.1	0.2	1.2	1.0	-0.1	0.3	0.7	-0.1	-0.2	0.7	0.5	-0.4
Value of the Dollar (4)	-0.12	-0.19	-0.19	-0.19	-12.9	-8.1	0.0	0.0	-20.0	0.0	0.0	0.0
Real GNP (5)												
Personal Consumption Expenditures (5)	-1.9	3.5	20.5	24.1	-0.1	0.3	1.0	0.2	-0.2	0.8	0.9	-0.2
Nonresidential Fixed Investment (5)	-3.1	-7.0	-2.8	-2.2	-0.3	-0.4	0.4	0.1	-0.6	0.1	0.4	-0.1
Residential Investment (5)	-0.4	0.2	4.8	6.9	-0.2	-0.4	2.3	0.8	-0.5	-1.3	2.2	-0.0
Government Purchases (5)	-0.1	-0.5	-1.7	-3.1	-0.2	-0.8	-2.0	-2.4	-0.2	-1.4	-2.3	-2.2
	-0.2	-0.6	-0.7	-1.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
									----- CHANGES -----			
Inventory Investment (5)	-0.3	0.5	2.8	2.1	-0.3	0.8	2.3	-0.7	-0.5	2.0	1.6	-1.8
Net Exports of Goods and Services (5)	2.1	11.0	10.0	21.5	2.1	8.9	7.1	3.5	5.0	8.7	6.5	1.8
									----- PERCENT CHANGES -----			
Civilian Unemployment Rate (6)	0.0	-0.0	-0.2	-0.3	0.0	-0.1	-0.2	-0.1	0.0	-0.1	-0.2	-0.1
Federal Deficit (NIPA Basis) (1)	-0.9	-3.7	-15.2	-17.5	-0.9	-2.8	-11.5	-2.3	-0.7	-6.9	-10.5	2.3
91-Day Treasury Bill Yield (6)	0.1	0.4	1.0	1.2	0.1	0.2	0.4	0.5	0.1	0.5	0.7	0.3
Moody's Corporate Bond Yield (6)	0.0	0.2	0.7	1.2	0.0	0.2	0.5	0.5	0.0	0.3	0.6	0.4
Velocity (K2)	-0.03	0.01	0.03	0.04	-0.00	0.01	0.02	0.01	-0.00	0.02	0.02	0.01
Net Exports of Goods and Services (1)	-2.3	13.0	34.4	51.4	-2.3	13.0	23.7	17.0	-3.1	22.3	23.7	12.8
Exports (1)	3.0	17.8	44.7	67.7	3.0	14.8	26.9	23.0	9.0	19.4	31.2	17.0
Imports (1)	5.3	7.2	10.3	16.5	5.3	1.9	3.1	6.2	12.2	-2.8	7.3	4.3

1. Billions of Dollars   2. Index (1972=100)   3. Index (1967=100)   4. Index (1970=1.00)   5. Billions of 1972 Dollars   6. Percent

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TABLE 3.---40-PERCENT DOLLAR DEPRECIATION

	1984	1985	1986	1987	1984	1985	1986	1987	84-IV/ 83-IV	85-IV/ 84-IV	86-IV/ 85-IV	87-IV/ 86-IV
	---------- LEVELS ----------				-------------------- PERCENT CHANGES --------------------							
Gross National Product (GNP) (1)	3647.3	4013.8	4497.3	5095.3	10.2	10.1	12.0	11.3	9.8	11.1	11.7	10.9
GNP Implicit Price Deflator (2)	225.9	237.7	252.4	270.1	4.8	5.2	6.2	7.0	5.2	5.6	6.6	7.2
Compensation Per Hour (3)	363.0	386.4	414.6	449.3	4.9	6.5	7.3	8.4	5.6	6.8	7.7	8.8
Output Per Hour (3)	126.9	130.0	134.1	136.1	2.0	2.4	3.2	1.5	1.9	3.0	2.5	1.0
Value of the Dollar (4)	0.74	0.59	0.59	0.59	-22.8	-20.0	0.0	0.0	-40.0	0.0	0.0	0.0
Real GNP (5)	1614.4	1688.3	1781.9	1853.3	5.2	4.6	5.5	4.0	4.4	5.2	4.8	3.5
Personal Consumption Expenditures (5)	1047.1	1073.6	1113.8	1152.4	3.5	2.5	3.7	3.5	1.9	3.7	3.2	3.5
Nonresidential Fixed Investment (5)	190.1	206.9	230.8	248.6	13.1	8.9	11.6	7.7	9.8	9.9	10.3	6.1
Residential Investment (5)	55.7	55.3	54.1	53.0	5.6	-0.8	-2.2	-2.0	-1.2	-0.7	-3.2	-1.0
Government Purchases (5)	307.5	323.8	334.9	341.1	4.8	5.3	3.4	1.8	8.6	2.7	3.2	1.3
					-------------------- CHANGES --------------------							
Inventory Investment (5)	17.5	18.9	22.9	22.0	19.9	1.4	4.0	-0.9	11.5	1.8	1.8	-2.3
Net Exports of Goods and Services (5)	-3.4	9.8	29.4	36.2	-15.1	13.2	15.6	10.8	-4.2	17.4	15.5	6.9
Civilian Unemployment Rate (6)	7.9	7.3	6.4	5.7	-1.7	-0.6	-0.8	-0.7	-0.8	-0.8	-0.7	-0.7
Federal Deficit (NIA Basis) (1)	186.0	177.7	170.8	168.3	3.2	-8.3	-6.9	-2.5	-7.4	-14.4	-0.8	-0.7
91-Day Treasury Bill Yield (6)	9.5	10.5	12.8	13.8	0.9	1.0	2.3	1.0	0.5	2.0	2.7	0.5
Moody's Corporate Bond Yield (6)	12.6	12.4	13.8	15.6	-0.2	-0.2	1.5	1.7	-0.6	0.5	2.1	1.6
Velocity (M2)	1.60	1.63	1.69	1.73	0.03	0.03	0.06	0.04	0.03	0.05	0.06	0.03
Net Exports of Goods and Services (1)	-53.3	-39.1	9.9	56.4	-42.8	14.3	48.9	46.6	-30.0	39.9	54.6	37.1
Exports (1)	374.8	437.6	540.9	647.4	39.0	62.8	103.3	106.5	45.7	75.5	118.4	93.2
Imports (1)	428.1	476.6	531.1	591.0	81.7	48.5	54.5	59.9	75.7	35.5	63.9	56.2

DIFFERENCES FROM BASELINE FORECAST

	1984	1985	1986	1987	1984	1985	1986	1987	84-IV/ 83-IV	85-IV/ 84-IV	86-IV/ 85-IV	87-IV/ 86-IV
	---------- LEVELS ----------				-------------------- PERCENT CHANGES --------------------							
Gross National Product (GNP) (1)	-0.3	49.9	186.0	281.0	-0.0	1.4	3.3	1.7	-0.1	2.7	3.1	0.9
GNP Implicit Price Deflator (2)	0.7	2.0	3.6	6.2	0.3	0.6	0.6	1.0	0.5	0.6	0.7	1.1
Compensation Per Hour (3)	0.1	1.4	3.7	7.7	0.0	0.3	0.6	0.9	0.1	0.5	0.6	1.0
Output Per Hour (3)	-0.4	0.5	2.9	2.8	-0.3	0.7	1.8	-0.1	-0.5	1.7	1.4	-0.9
Value of the Dollar (4)	-0.24	-0.39	-0.39	-0.39	-25.7	-20.0	0.0	0.0	-40.0	0.0	0.0	0.0
Real GNP (5)	-5.1	6.6	49.8	62.6	-0.3	0.7	2.5	0.7	-0.6	1.9	2.2	-0.3
Personal Consumption Expenditures (5)	-7.0	-13.3	-2.9	-0.0	-0.7	-0.6	1.0	0.3	-1.4	0.5	0.9	-0.1
Nonresidential Fixed Investment (5)	-1.1	-0.0	11.3	17.5	-0.6	0.6	5.5	2.4	-1.3	3.0	5.4	0.4
Residential Investment (5)	-0.4	-1.2	-3.4	-6.9	-0.8	-1.4	-4.0	-6.2	-1.2	-2.0	-5.1	-6.1
Government Purchases (5)	-0.5	-1.1	-1.4	-2.7	-0.2	-0.2	-0.1	-0.2	-0.3	-0.1	-0.1	-0.3
					-------------------- CHANGES --------------------							
Inventory Investment (5)	-0.0	1.0	6.8	5.7	-0.8	1.9	5.7	-1.0	-1.6	5.2	4.1	-3.9
Net Exports of Goods and Services (5)	3.7	21.2	38.4	48.6	4.7	16.5	17.2	10.3	10.0	17.3	17.5	5.3
Civilian Unemployment Rate (6)	0.1	-0.1	-0.5	-0.8	0.1	-0.1	-0.5	-0.3	0.1	-0.4	-0.5	-0.2
Federal Deficit (NIA Basis) (1)	-0.7	-8.8	-38.1	-46.8	-0.7	-8.1	-29.3	-8.7	0.3	-19.4	-27.7	4.3
91-Day Treasury Bill Yield (6)	0.3	0.3	2.3	3.6	0.3	0.5	1.5	1.4	0.3	1.0	1.9	1.1
Moody's Corporate Bond Yield (6)	0.1	0.5	1.6	3.1	0.1	0.3	1.1	1.5	0.2	0.6	1.4	1.5
Velocity (M2)	-0.00	0.02	0.07	0.10	-0.00	0.02	0.05	0.03	-0.00	0.04	0.05	0.01
Net Exports of Goods and Services (1)	-1.0	24.5	89.5	127.1	-1.0	25.5	55.9	46.7	-0.7	43.3	61.8	34.9
Exports (1)	6.6	36.6	101.8	165.2	8.6	28.0	65.2	63.4	15.1	38.4	80.5	47.4
Imports (1)	9.5	12.0	21.4	38.2	9.5	2.5	9.4	16.8	15.8	-4.9	18.7	12.6

1. Billions of Dollars. 2. Index (1972=100) 3. Index (1967=100) 4. Index (1970=1.00) 5. Billions of 1972 Dollars. 6. Percent

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BEA QUARTERLY ECONOMETRIC MODEL FORECAST
FEBRUARY 27, 1984

TABLE 4.--30-PERCENT DOLLAR DEPRECIATION

	1984	1985	1986	1987		1984	1985	1986	1987	84-IV/ 83-IV	85-IV/ 84-IV	86-IV/ 85-IV	87-IV/ 86-IV
	------ LEVELS ------							------ PERCENT CHANGES ------					
Gross National Product (GNP) (1)	3648.3	3970.6	4393.1	4396.9		10.2	9.1	10.4	11.5	9.9	9.2	10.8	11.5
GNP Implicit Price Deflator (2)	225.3	236.5	250.9	267.7		4.5	5.0	6.1	6.7	4.8	5.5	6.5	6.7
Compensation Per Hour (3)	362.9	335.5	413.0	446.3		4.9	6.2	7.1	8.1	5.5	6.6	7.5	8.4
Output Per Hour (3)	127.3	129.5	132.3	135.3		2.3	1.8	2.1	2.3	2.3	1.5	2.2	2.1
Value of the Dollar (4)	0.90	0.73	0.69	0.69		-5.8	-18.4	-6.3	0.0	-15.0	-17.6	0.0	0.0
Real GNP (5)													
Personal Consumption Expenditures (5)	1619.4	1682.6	1750.9	1829.2		5.5	3.9	4.1	4.5	4.9	3.5	4.0	4.4
Nonresidential Fixed Investment (5)	1052.5	1073.8	1108.7	1149.7		4.1	2.5	2.8	3.7	2.9	2.6	2.8	3.9
Residential Investment (5)	191.1	206.8	223.2	241.2		13.8	8.2	7.9	8.0	10.9	3.1	7.7	7.7
Government Purchases (5)	56.1	56.0	55.7	56.0		6.4	-0.2	-0.4	0.5	-0.2	0.0	-0.9	1.1
	307.8	324.3	335.2	311.8		4.9	5.4	3.4	2.0	8.7	2.6	3.2	1.5
								CHANGES					
Inventory Investment (5)	18.3	17.9	18.6	20.7		20.7	-0.4	0.7	2.1	13.0	-2.9	1.1	1.9
Net Exports of Goods and Services (5)	-6.3	-1.1	9.4	19.8		-18.0	5.2	10.5	10.4	-10.1	10.9	10.2	9.3
Civilian Unemployment Rate (5)	7.8	7.3	6.7	6.0		-1.0	-0.5	-0.6	-0.7	-0.9	-0.5	-0.5	-0.7
Federal Deficit (NIA Basis) (1)	105.2	103.4	195.3	166.6		2.4	-1.8	11.9	-0.8	-9.5	2.2	11.1	-14.6
91-Day Treasury Bill Yield (6)	9.2	10.1	11.7	12.2		0.6	0.9	1.6	0.5	0.4	1.5	1.8	0.2
Moody's Corporate Bond Yield (6)	12.5	12.1	11.0	14.1		-0.3	-0.4	0.9	1.1	-0.7	0.1	1.4	1.0
Velocity (M2)	1.60	1.61	1.65	1.69		0.03	0.02	0.04	0.04	0.03	0.02	0.04	0.04
Net Exports of Goods and Services (1)	-53.4	-59.0	-37.0	1.4		-42.8	-5.6	22.0	38.4	-30.7	0.9	31.2	36.6
Exports (1)	368.9	416.7	469.0	578.9		33.1	47.8	72.3	89.9	35.8	56.5	81.1	90.8
Imports (1)	422.2	475.6	525.9	577.5		75.0	53.4	50.3	51.6	66.5	47.6	49.8	54.2

DIFFERENCES FROM BASELINE FORECAST

	1984	1985	1986	1987		1984	1985	1986	1987	84-IV/ 83-IV	85-IV/ 84-IV	86-IV/ 85-IV	87-IV/ 86-IV
	-------- LEVELS --------							-------- PERCENT CHANGES --------					
Gross National Product (GNP) (1)	0.8	14.6	61.9	172.6		0.0	0.4	1.7	1.9	0.1	0.7	2.1	1.5
GNP Implicit Price Deflator (2)	0.1	0.7	2.1	4.7		0.0	0.3	0.6	0.6	0.1	0.4	0.6	0.7
Compensation Per Hour (3)	0.0	0.5	2.0	3.9		0.0	0.1	0.4	0.6	0.0	0.2	0.5	0.7
Output Per Hour (3)	-0.0	0.0	1.0	1.9		-0.0	0.0	0.8	0.7	-0.1	0.2	1.1	0.2
Value of the Dollar (4)	-0.08	-0.25	-0.29	-0.29		-8.7	-18.4	-6.3	0.0	-15.0	-17.6	0.0	0.0
Real GNP (5)													
Personal Consumption Expenditures (5)	-0.0	0.9	17.8	30.5		-0.0	0.1	1.0	1.2	-0.0	0.2	1.4	0.7
Nonresidential Fixed Investment (5)	-1.6	-8.2	-7.9	-2.8		-0.2	-0.6	0.0	0.5	-0.4	-0.6	0.5	0.3
Residential Investment (5)	-0.0	-0.1	-3.7	10.0		-0.0	-0.6	1.9	2.7	-0.2	0.3	2.8	2.0
Government Purchases (5)	-0.0	-0.5	-1.7	-3.9		-0.1	-0.8	-2.2	-3.8	-0.2	-1.3	-2.8	-4.0
	-0.1	-0.6	-1.1	-1.5		-0.1	-0.1	-0.1	-0.1	-0.1	-0.2	-0.1	-0.2
								CHANGES					
Inventory Investment (5)	-0.0	0.1	2.4	4.4		-0.0	0.1	2.4	2.0	-0.1	0.5	3.3	0.3
Net Exports of Goods and Services (5)	1.8	10.1	22.4	32.3		1.8	8.4	12.1	9.9	3.9	10.8	12.2	7.8
Civilian Unemployment Rate (6)	0.0	-0.0	-0.2	-0.5		0.0	-0.0	-0.2	-0.3	0.0	-0.0	-0.3	-0.2
	-1.5	-3.0	-11.5	-20.5		-1.5	-10.5	-14.9	-14.9	-1.8	-2.7	-15.8	-9.7
	0.1	0.4	1.2	2.0		0.1	0.3	0.8	0.9	0.2	0.4	1.0	0.8
	0.3	0.2	0.8	1.6		0.0	0.2	0.6	0.9	0.1	0.3	0.8	0.9
	0.00	0.01	0.03	0.06		0.00	0.01	0.02	0.01	0.00	0.01	0.03	0.02
Net Exports of Goods and Services (1)	-1.0	4.6	33.6	72.1		-1.0	5.6	29.0	36.5	-1.4	12.3	38.4	34.4
Exports (1)	2.7	15.7	43.9	96.7		2.7	13.0	33.2	46.8	5.2	19.4	43.2	45.0
Imports (1)	3.6	11.0	16.2	24.7		3.6	7.4	5.2	8.5	6.6	7.2	4.6	10.6

1. Billions of Dollars 2. Index (1967=100) 3. Index (1967=100) 4. Index (1970=1.00) 5. Billions of 1972 Dollars 6. Percent

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Appendix A

Effect of a Dollar Depreciation on the Investment

and Capital Goods 1/ Sectors

The U.S. runs a large trade balance surplus in capital
goods, in fact, the largest of any major end-use category. In
1982, exports of capital goods were $72.7 billion and imports
were $38.2 billion. For 1983, exports are expected to be about
$67.1 billion and imports about $39.2 billion.

This paper begins with the premise of a 10 percent
spontaneous depreciation of the dollar. Larger (or smaller)
depreciations will yield results proportionately greater (or
less). The subsequent effects on the traded and non-traded
investment goods sector 2/ are divided into 3 parts:

1. The direct effect on the capital goods trade balance due to
   a lower value of the dollar.

2. The nature of interest rate changes and their effect on
   private domestic investment.

3. The indirect interest rate effects on the capital goods
   trade balance.

1/ Electrical and nonelectrical machinery, civilian aircraft
   and other transportation vehicles, excluding automotive.

2/ For purposes of exposition it is perhaps better to think of
   exports and imports of capital goods as the portion of
   fixed private domestic investment goods that is traded
   internationally.

2

Direct Effects on the Capital Goods Trade Balance

According to econometric work done in the 1970s, U.S. exports of capital goods are not very price elastic, but tend to be strongly affected by changes in economic activity outside the U.S. Estimates of the price elasticity of imports are higher, presumably because of the greater possibilities for substitution which domestic residents enjoy.

Accordingly, a 10 percent depreciation of the dollar will increase export revenues by 6 percent and decrease import expenditures by 7 percent after 2 years. This translates into an improvement of $6.8 billion in the capital goods trade balance. Of course, in the very short run the elasticities are much smaller. In the first 2 quarters the depreciation will have a perverse effect and the trade balance will decline.

The Nature of Interest Rate Changes and Their Effects on
Private Domestic Investment

The lower value of the dollar and the resulting improvement in the current account generate two distinct negative effects on the domestic demand for traded and non-traded investment goods.

The medium-term and long-term improvements in the current account from a lower value of the dollar will tend to increase demand for export goods and for import-competing domestic goods. As with any expansion in aggregate activity, money demand rises. If monetary policy is not changed, interest

3

rates will rise. This type of increase in rates is known as transactions crowding out.

Even though the traded goods sectors expand, higher interest rates are a negative factor for the interest sensitive sectors. Thus, the expansionary effect of the decline of the dollar increases total expenditures, but changes the output mix away from capital goods and toward traded goods.

There is a second, independent source of upward pressure on the interest rate subsequent to a devaluation. Transactions crowding out occurs when the economy expands regardless of the source and a real balance effect occurs in the money markets as a direct consequence of the fall in the dollar. As the value of the dollar declines, prices of imports and of import-competing products rise. Studies show that a 10 percent depreciation will raise the level of the CPI 1 percent after 15 months and 1.5 percent permanently. In the absence of a change in monetary policy, higher prices mean lower _real_ money balances, and thus an even higher interest rate, if the demand for money depends on the CPI is opposed to the GNP deflator. Activity in interest-sensitive sectors will thereby decline relatively, on this account lowering the level of total output, and further altering its mix away from investment goods.

On balance, it is difficult to say whether total output will increase or decrease, because these two effects act in opposite directions. It is clear, however, that the sectoral expansions which occur will be strongest in the traded goods

industries. It is also clear that the sharpest declines will
be in interest-sensitive sectors.

Of course, capital goods are traded and are also interest
sensitive. Capital goods exports will increase by about 6
percent or $4.0 billion 2 years after a 10 percent
depreciation. But this increase will be offset by a relative
fall in domestic expenditure on capital and investment goods
due to higher interest rates.

During the first 6 months following the depreciation the
current account deficit will worsen and the capital inflow will
increase, precisely the opposite of the long-run effect. It
would be misleading, however, to apply the above arguments in
reverse to the short run. Though short-term interest rates may
fall, long-term rates, which more accurately reflect the
opportunity cost of investment purchases, should rise
somewhat. Consequently, the short run impact of a dollar
depreciation on demand for capital goods is not much better.

Indirect Effects on the Trade Balance of Capital Goods

In addition to the direct improvement in the capital
goods' trade balance there is a second, indirect improvement
resulting from the depreciation of the dollar and the
subsequent rise in interest rates. Imported capital goods are
even less attractive than they were after their relative price
increased because of the higher interest costs. Instead of
falling by 7 percent, expenditure on imports of capital goods

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will decline by 12 percent after 2 years. Thus the capital

goods trade balance will improve by more than the price

elasticities alone would indicate.

In sum, the total long run effect of a 10 percent

depreciation is to increase the capital goods trade balance by

$8.7 billion. But as the current account improves, capital

inflows will wane. The supply of funds available for

investment will shrink forcing interest rates to rise.

Appendix B

The Impact of a 20-Percent Depreciation of the Dollar on
U.S. Farm Exports

In the absence of changes in other factors, an
inflation-adjusted depreciation of 20 percent during 1984 would
restore U.S. export volumes of wheat, corn, and soybeans, to
their pre-appreciation levels and boost prices and, hence,
values to nearly those levels. The gains due to a depreciation
may not be apparent until fiscal 1986, given lags of perhaps
6-18 months between exchange-rate changes and commodity trade
movements.

   o Export volumes would increase by 14 percent (+16.6
     million tons),

   o Export values would increase by 19 percent (+$3.4
     billion), and

   o Export prices would increase by 6 percent.

Export volumes for corn would change more than the other
commodities; a similarly large change was seen in the volume of
corn exports during the appreciation of the dollar in 1981 and
1982. It is estimated that the quantity exported of:

   o Corn would rise 16 percent,

   o Wheat would rise 11 percent, and

   o Soybeans would rise 10 percent.

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This analysis represents the effects on U.S. exports if the dollar were to depreciate uniformly against all currencies. Recently, however, the dollar has declined more against the European currencies than against the Japanese yen, and has continued to appreciate against the Canadian dollar and currencies of most developing countries. If this behavior continues, both the quantities exported and the prices of soybeans could increase more, while corn and wheat may show smaller gains.

Other factors are assumed to be static, but it is important to point out a critical factor for agricultural exports. Weak Gross National Product growth in the overseas industrialized countries, especially in Europe, and debt in many key developing country markets may remain a mitigating factor through 1984 and into 1985. Thus, the export expanding impacts of depreciation may be partly offset by the influence of dampened effective demand.

Impact of Strong Dollar on Demand for

U.S. Farm Exports 1/

After adjusting for inflation, the dollar appreciated roughly 10 percent per year in both 1981 and 1982. The dollar's rise is estimated to have reduced:

o Export prices by 5 percent,

o Export values by 16 percent ($3.4 billion), and

o Export volumes by 12 percent (16 million metric tons).

Export prices for each of the commodities declined at roughly equal rates. Thus, variability of volumes caused the variation in export values. Estimates of volume impact differ by commodity:

o Wheat volume fell by 10 percent,

o Corn volume fell by 15 percent, and

o Soybean volume fell by 8 percent.

Thus, the implied elasticities of export volume with respect to an exchange-rate appreciation, were:

o .5 for wheat,

o .8 for corn, and

o .4 for soybeans.

1/ Based on a study by the Economic Research Service entitled, Strong Dollar Dampens Demand for U.S. Farm Exports, AER 193, U.S. Department of Agriculture.